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THEORETICAL PERSPECTIVES OF CORPORATE GOVERNANCE

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Abstract
Corporate governance is primarily about how investors "engage" managers in order to provide them with a return on their invested capital. This issue is affected by agency theory, which seeks to smooth and moderate the consortium of managers towards effective management activities that ensure performance commensurate with investment. This paper focuses mainly on the analysis of the concept of corporate governance from the perspective of existing theoretical and practical approaches, and captures the evolution of the notion as well as the principles and theories that interweave the complexity of the phenomenon.

Key words: *corporate governance; stakeholders; performance; theories*

JEL Classification: *M41, G32, G39*

I. INTRODUCTION

Concerns about corporate governance, ethics, transparency and accountability have grown significantly over the decades. These issues have become commonplace for companies and have also permeated much of the academic literature. Under the umbrella of corporate governance, in addition to concern for shareholder wealth and fortune, we see significant interest in the interests of the various stakeholders of the entity. Stakeholders are recognized in the literature as 'stakeholders' or 'stakeholder groups'. If we look at accounting standards we can easily see that stakeholders are identified with users of accounting information. Therefore, shareholders, board members, managers, creditors, customers, suppliers, even the state are users of financial information and their interests all converge in the same direction: "to decipher the performance of the economic and financial enterprise and the risks they take by collaborating with it" (Feleagă & Feleagă, 2007: p. 20).

Since the entire evolution of human societies has been conditioned by the permanent engagement of information capacity, we can say that the only inexhaustible resource that human civilization has and produces is information. For good governance we need an information system for management, i.e. "a set of human and capital resources invested in an economic unit to collect and process the data needed to produce information for the control and management of the activity" (Oprea, 1995). In recent years the heated discussions on corporate governance have had a variety of repercussions on corporate organizations as well as management. The influences have been due to existing theories, but also to the governance models developed by each individual nation. In what follows, we will look at these theories in more detail.

In reviewing the literature, we initially found that there are four historical theoretical sources that have led to the formation of the notion of corporate governance, namely: agency theory, stewardship theory, stakeholder theory and the politics of the firm. The dynamism of the development of the economy in general, and of companies in particular, has brought to light other theories such as resource dependency theory, transaction cost theory and hegemonial management theory.

II. AGENCY THEORY

This theory emerged in the early 1970s in the American economic literature as a result of the analysis of the relationships between managers (called agents) and owners in companies. This theory comes up with the idea of separating management from shareholders, or in standard terminology, ownership from control. In essence, the theory distinguishes governance relationships as a formal or informal contract between shareholder (principal) and manager (agent). It has been shown that managers seek to maximize their personal benefits, to act in a manner that is advantageous to them, but often do so at the expense of the interests of shareholders.

Those who best explain the phenomenon are Jensen & Meckling (1976), the founders of this theory: agency theory involves a contract where one or more persons (shareholders) hire other persons (directors) to perform

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certain services on their behalf, which includes the delegation of decision-making authority to the agent. If the two parties to the relationship are seeking maximum benefit, there is good reason to believe that the agent will not always act in the best interests of the principal.

In this case, there is the issue of mistrust that may arise between the participants, in the sense that the owner may feel that the director is not adequately protecting his interests. The option left to the owner is to set appropriate limits for the agent, requiring him to bear the costs of monitoring. Another option would be to pay the agent, thus ensuring that the agent acts in accordance with good governance principles. It is obvious that at zero cost neither the beneficiary nor the agent will be able to guarantee the best conduct of the agent, i.e. making the most correct decisions from the beneficiary's point of view, and so there will always be agency issues between decisions made by the manager and those decisions that would increase the "principal's revenue".

We can therefore say that agency theory explores how contracts and allowances can motivate individuals involved in the smooth running of a business to achieve the goals defined by the organization (see Figure 1). A strength of this theory is its explanatory power in that it highlights very well the relationships between shareholders, board members, managers and employees. Can we really name the manager as the core of our theory? The answers are divided, but what is certain is that it is an important factor in the long-awaited value creation process and has the ability to influence the distribution of profits.

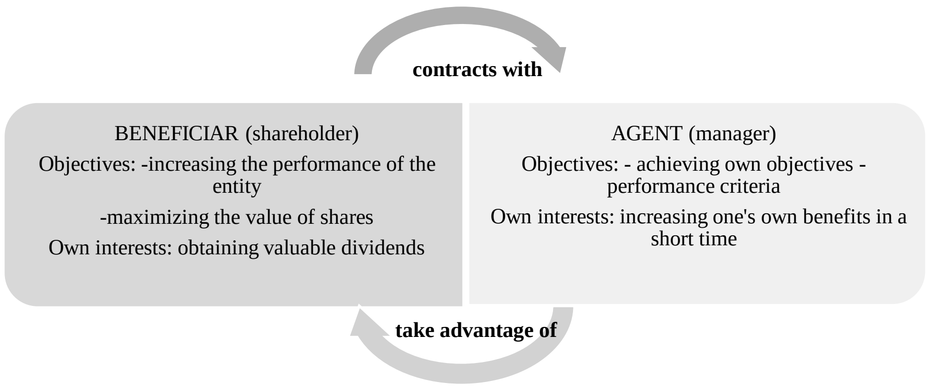

Figure 1 – Agent theory model
Source: own projection

In addressing agent issues, Tricker (2015) emphasizes the importance of corporate governance codes and recommendations, considers stock exchange rules and regulations as well as various reporting requirements, audit input and transparency.

Shareholder and manager grievances may encompass not only the results, returns and benefits sought, but also the corporate risk itself, as managers manage shareholders' money and not their own funds. Surely the situation would be different if senior management owned shares in the company they manage. We intend to examine this issue in detail in the practical part of this study.

Most corporate governance research has used agency theory developed with the support of economic and financial disciplines. By looking at governance through the lens of this theory, scholars have discovered connections between the corporate governance process and performance. In other words, they looked for causal links between the governance system and the outcomes produced. There are many examples, but here are a few that we propose to examine in the practical section of this thesis: testing the correlation between board structure (percentage of independent directors, number of board members, frequency of board meetings, existence of specialist committees) and financial performance.

III. Administration Theory

Compared to agency theory, stewardship theory looks at governance from a different perspective, reflecting the legal form in which each company is constituted. Joint stock companies flourished during the 19th century. Limited liability companies provided capital, encouraged and supported business development, guaranteed employment, created innovations in industry and commerce, producing untold wealth for over 150 years. This model has proven to be a robust one with excellent resilience.

In essence, each company should be seen as a legal entity in its own right. Shareholders appoint directors who then act as good stewards for their interests. The latter report to them the results of their stewardship, which are confirmed in advance by an independent auditor who has expressed a true and fair opinion on the company's

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financial position. Ownership is the basis of power for the whole corporation. For this reason, directors have a moral responsibility for the proper stewardship of shareholders' assets. Intrinsic in companies is the belief that managers are trustworthy and will do good work in the interests of the owners.

Thus, we see that this theory of stewardship portrays the classic idea of corporate governance. A company is seen more precisely as a team within which all members contribute to its success. This theory supports the duality of the position of chairman of the board with that of chief executive officer (CEO) because it is necessary for a corporation to concentrate power and authority on one individual. In contrast, the agency theory argues that the position of CEO and that of chairman of the board should be separate because the board has the role of monitoring managers. Agency theory assumes that managers pursue their own interests, while stewardship theory suggests that managers often have similar interests to shareholders. One explanation is that managers link their personal reputations to the operational performance of the firms they manage, and are thus motivated to maintain their professional expertise. To explicitly highlight the relationship between shareholders and managers in the case of management theory, we constructed Figure 2.

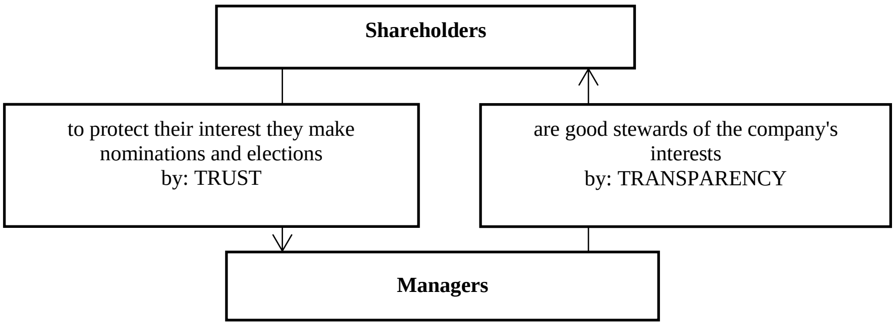

Figure 2 – The model of administration theory
Source: own projection

We believe that this theory of stewardship portrays the classic idea of corporate governance. A company is seen more accurately as a team within which all members contribute to its success. This theory supports the duality of the position of chairman of the board with that of chief executive officer (CEO) because it is necessary for a corporation to concentrate power and authority in one individual. In contrast, the agency theory argues that the CEO position and the board chair position should be separate because the board has the role of monitoring managers (Ghofar & Islam, 2015). Agency theory assumes that managers pursue their own interests, while stewardship theory suggests that managers often have similar interests to shareholders. One explanation is that managers link their personal reputations to the operational performance of the firms they manage, thus, they are motivated to maintain their professional expertise. In the light of the major financial collapses of recent years, it has been shown that this theory is no longer as secure in the sense that managers may not always be bona fide, and their behaviour may be damaging to shareholders, creditors, employees or even the community as a whole.

IV. INTEREST GROUP THEORY

Stakeholders theory, as it is known in English, can be seen as a general theory of all entities. The word 'stakeholder' was coined to stand in juxtaposition with 'shareholder', recognizing the direct or indirect interest of all those affected by company decisions, including customers, employees and managers, suppliers, bankers, shareholders, the local community and even the state.

This theory is based on the premise that the primary focus of the business environment is the added value created, and this can only be achieved if entities protect stakeholders' interests. We deduce from this the idea that managers have duties that serve a complex system of relationships as there are different objectives and interests for each category of stakeholders. Viewed from a corporate governance perspective, the theory lays the foundation for accountability and responsibility to stakeholders and the wider community.

The challenge for the board of directors who try to address only the shareholder issue is that they no longer have a single stakeholder, the shareholders, to satisfy, but have a responsibility to balance conflicts of interest between various stakeholders.

I have encountered opinions in the literature that stakeholder theory ideas are fundamentally flawed because they strongly advocate the property rights perspective. Potential conflicts between the expectations of different stakeholders are irreconcilable, and the main argument is that a board of directors is focused on the interests of

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shareholders and less on that of interest groups (Sternberg, 1997).

There are also opposing views that highlight corporate interests, as the expectations of all companies around the world are changing, with increasing demands for quality social, environmental and consumer behaviour. Turnbull (2012) based on stakeholder theory, developed the idea of network governance. It looks at the relationships within an entity as an internal network of control centres producing distributed intelligence. The basic requirement of this idea is the introduction of a division of powers within the company, i.e. more precisely, the separation of conflicts of interest. This allows for checks and balances at the management level and serves, as we see in Figure 3. all stakeholder groups.

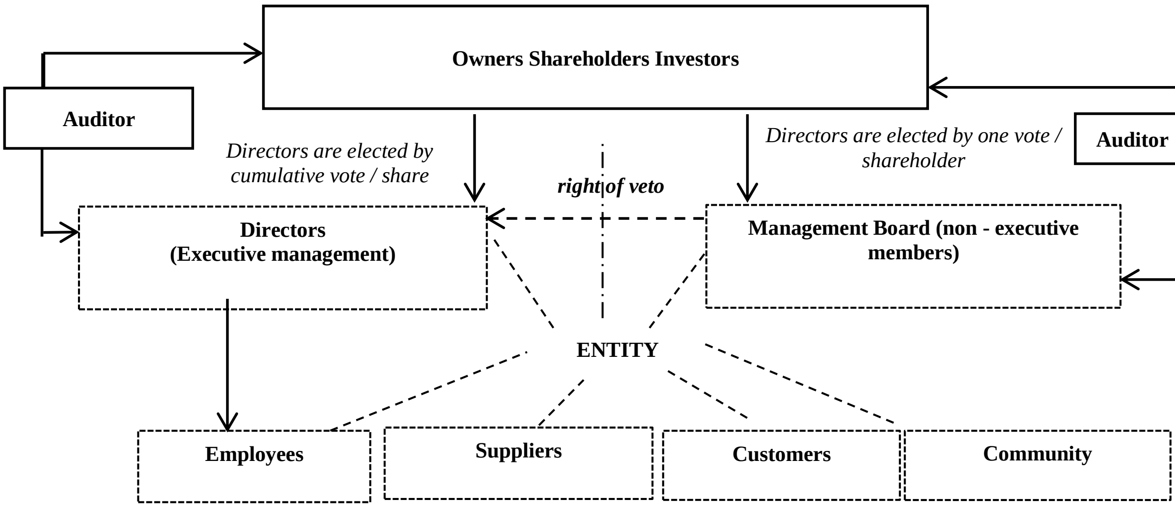

Figure 3 – Stakeholders model
Source: projection after Turnbull, 2012

The issue has been raised that stakeholder will be subject to opportunistic exploitation by the firm and its shareholders if corporate managers are accountable only to the firm's shareholders. Corporate law must ensure that managers will also be responsive to stakeholder interests (Morariu, Sucius & Stoian, 2008: p.33).

We can see from the figure above the separation of authorities by levels of management and the ideal governance structure, which implies a balance between independent non-executive and executive members. It highlights the governance structure and process to oversee management and board performance as well as the responsibilities of shareholders and other stakeholders.

Analyzing all three models presented above, agency, management and stakeholder theory, we can say that each one has some basic elements that cannot be solved nor applicable to all companies. Each theory of governance must be grounded in the legitimate relationship between the individual and society. The question now arises, which way do we tip the scales when we talk about the rights, responsibilities and power an individual, a company or the state has? Of course the answers will differ according to culture, political context and social system. Moreover, they evolve over time. All governance systems must seek an appropriate balance between self-interest and society. And this custom must be applied to corporate governance as it is applied to governance in other areas of society.

V. Transaction Cost Theory

Closely related to agency theory, transaction cost economics was derived from Coarse's 1937 paper. He found that a firm could save costs by carrying out certain activities in-house rather than outsourcing them. In other words, it shows how entities can minimize the costs of exchanging resources or services at a below-market price and also reduce bureaucratic costs within the firm.

The theory was developed by Williamson (1979) around the 1980s, and starts from two essential premises. First, the transaction is the basic unit of analysis in economics, comprising three independent principles: of conflict, reciprocity and order, and second, an indispensable requirement for optimizing resource allocation and increasing economic performance is economic governance. The author emphasizes the need for an organized and optimal institutional framework for carrying out transactions, and designates governance as the engine that organizes and settles potential conflicts that threaten the opportunity for gain (Figure 4).

The transactional cost approach refers to those execution costs or "checks and balances" mechanisms

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incurred by: internal and external audit controls, disclosure, independent non-executive directors, separation of the position of chief executive officer (CEO) from that of chairman of the board, risk analysis, audit, standard setting and remuneration committees. The argument is sound because trading costs need to be sustained until their increase equals the reduction in potential losses in case of non-compliance.

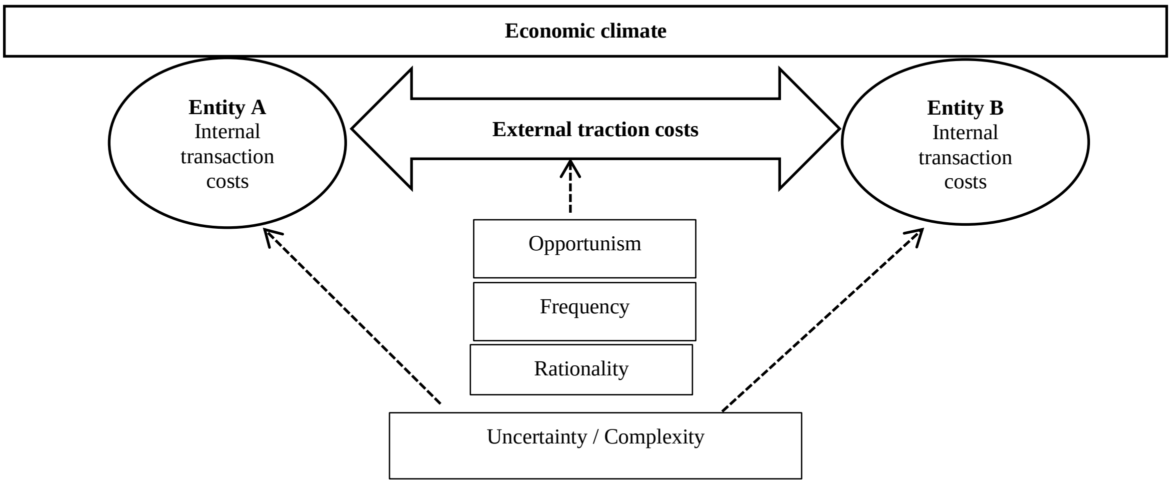

Figure 4 - Transaction cost theory model
Source: own processing

We believe that this theory brings practical value to the work of companies because the same transactions carried out on the market or within the firm are treated differently by state bodies or other authorities regulating price levels. If we take into account VAT, customs duties, excise duties, we see that only market transactions and not intra-company transactions are concerned. Consequently, such regulations lead to the emergence of commercial entities, which otherwise could not exist (Crenicean, 2013:34).

An interesting approach to the present theory we found in Nolan & Trew (2011), for whom transaction costs are conceived as human interaction costs other than those in the production cost category. These arise at the time of the contractual transfer of property rights from one economic agent to another.

Unlike agency theory, transaction cost theory explicitly uses the concept of governance. The governance issue that arises at this level concerns the successful performance of an entity's operations in the same assent with the political and cultural environment, compared to other theories that prioritise the protection of shareholders' interests.

VI. Political Model Theory

This theory highlights the political factor in the distribution of power at the level of management, privileges and benefits to stakeholders. It makes its presence felt through all public policies with reference to business entities, through economic and social development programmes, through the influence and deeply felt interests of political parties in the life of companies. In turn, large corporations have influenced the political sphere, the most important achievement being the emergence of cumulative voting in some states, which benefits minority interests in that they have the right to elect directors (Turnbull, 2012).

The policy model brings into question real issues of the economic environment, such as market liquidity, institutional control, investor rights and interests, supply and demand policy and even governance.

Of course, we must appreciate the need for politics to exist as a mechanism for regulation, oversight and control, but in recent times the government has had a strong influence on entities and not necessarily in a positive sense. We mention here the allocation of corporate power, profits and privileges determined by the groups in power, stifling bureaucracy, corruption and, why not, economic stagnation.

VII. Resource Dependence Theory

This issue is a rather delicate one, and we are not talking here only about a certain field, but about the survival of mankind in a general sense. We are dependent on resources: air, water, food, shelter, physiological needs being indispensable to life. In order to procure resources, individuals will seek to establish relationships with other people, thus creating dependencies. We find the same survival system in companies, their interest being to depend as little as possible on other entities or to increase the dependence of others on them.

The theory focuses on the environment as it is the main source for obtaining the resources, otherwise limited, necessary for survival, and within a company, the management committee is responsible for obtaining them. Therefore, corporate governance is seen as a strategy in the game of obtaining the necessary resources to achieve the proposed objectives. These resources may include, for example, connections to relevant markets with potential customers and competitors, access to capital and other sources of funding, willingness to know-how and technology, business partnerships or other political, social, etc. links (Tricker, 2015: 68-69). We ask ourselves, who is responsible for carrying out the strategy? The answer is as suggested above: corporate governance through board members, as they have, or should have, the qualities needed to connect the business with the necessary resources. Managers, administrators or even their president represent the "nodes" with the external environment and those who provide information and skills, those who establish collaborative relationships with suppliers, customers, state institutions and social groups.

I believe that the role of corporate governance in identifying and obtaining the necessary resources is essential and must be taken very seriously by members of management.

VIII. Hegemonial Management Theory

This view of corporate governance focuses on the hegemony of managers, as they often take control of companies, even though the owners are the legal owners. We also look at the effects of such behaviour on corporate governance. Some executives see themselves as the elite group in the company, and this personal perception encourages them to adopt related behaviour, dominating both the company's structure and its external links. In this context, newcomers to top management need to settle quickly into the elite team and must maintain the image created. Similarly, independent directors are only appointed if they fit this leadership model and support the dominance of the governance group (Tricker, 2015).

We note in the model presented that the role of the board of directors is a symbolic one, strictly organizational, that of legitimizing the decisions and actions of managers. This "emblematic" position makes it an ineffective body in controlling and supervising managers, affecting their behaviour and, implicitly, their performance.

We can say that the theory of hegemonial management has its roots in socio-political disciplines but was founded on practical research combined with representative literature reviews. Essentially, these studies see governance as an interpersonal and political process and critics do not recommend dominant management as a model of leadership.

In the sense of what has been presented, it can be say that the theories analysed have contributed to the development of the concept of corporate governance, and their importance and parameters are still being addressed with interest by researchers.

IX. Conclusions

In order to highlight the theoretical link between corporate governance mechanisms and the financial-accounting performance of the firm we can be guided by agency theory. It helps us to explain the conflicts of interest existing in large companies and its impact on the financial performance of entities. Dysfunctional corporate governance creates, according to agency theory, conflicts of interest and bad and immoral management. This conglomerate will bear a set of unbeatable risks such as: increased accounting risk, equity risk, liabilities as well as strategic risks. Of course, these consequences will negatively influence the position of existing and future investors. On the other hand, good governance, with all its mechanisms, contributes to increasing the value of the company, increases performance and investor confidence and at the same time reduces the financial problems of the corporation.

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